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TAGS: ECON ETRD EFIN EINV EIND ELAB
SUBJECT: IRELAND'S GAME PLAN ON ECONOMIC COMPETITIVENESS

¶1. Summary: Firms in Ireland must move increasingly into high-value goods and services in order to safeguard the country's prosperity, advises a high-profile, government-commissioned report on Ireland's economic competitiveness. The report notes that rising costs, poor performance by indigenous firms, changes in EU policies, and accelerating globalization threaten to overpower the factors underlying Ireland's economic success during the past decade. The report recommends that the Irish Government assist firms with the transition into high-value goods and services by promoting enhancements to sales/marketing expertise and technology/R&D capability. An Irish Central Bank economist, however, questions that approach, arguing that indigenous enterprises should leave heavy R&D investment to foreign-owned firms. Despite Ireland's worries about competitiveness, U.S. firms continue to see the country as an attractive investment destination and export platform. End summary.

The Focus on Competitiveness

¶2. Concerns about Ireland's competitiveness as an exporter and foreign direct investment (FDI) destination have featured prominently in recent Irish economic commentary, even as the country's economy continues to perform strongly. In late August, for example, a Department of Finance report forecasting the second half of 2004 warned, "We cannot afford to worsen our already deteriorating competitive position." By contrast, the same report upgraded projections for GDP growth in 2004 from 3.3 percent to 4.7 percent, lowered predictions for average annual inflation from 3.0 percent to 2.2 percent, and forecast a government surplus of euro 600 million. In public comments on the report, Finance Minister Charlie McCreevy downplayed this rosy outlook and reiterated that "regaining competitiveness is a key priority if we are to safeguard our economic success."

¶3. Recent attention to competitiveness derives primarily from a new, long-anticipated report entitled "Ahead of the Curve: Ireland's Place in the Global Marketplace" -- essentially, a game plan for Ireland to sustain exports, FDI, and economic prosperity in the face of international competition. The report was written by the Enterprise Strategy Group (ESG), established by Deputy Prime Minister Mary Harney in 2003 with 21 representatives of industry, labor, academia, and government (primarily Forfas, the government office that coordinates Ireland's business-promotion agencies). Eoin O'Driscoll, Executive Vice President (and soon President) of the American Chamber of Commerce, chairs the ESG and was the Chamber's channel for significant input into the report. With additional contributions from over 250 people, the ESG report is Ireland's broadest industrial policy statement since the 1992 Culliton Report, which called for the development of an export-oriented enterprise sector and thus set the stage for the emergence of the Celtic Tiger economy.

The Cause for Worry

¶4. The ESG report argues that the factors underlying Ireland's economic success over the past decade do not adequately address emerging challenges to the country's continued competitiveness. These positive factors have included: ease of access to EU markets and EU regional aid; an open climate for trade and FDI; a favorable corporate tax regime (a single rate of 12.5 percent that applies to both foreign and Irish firms), fiscal policies that minimize government debt; burgeoning global trade (particularly in the IT and life-science sectors, recipients of substantial FDI in Ireland); and the availability of young, educated labor. The challenges that threaten to overpower these factors, however, are primarily:

A) Rising costs: Forfas ranks Ireland as the most expensive country in the euro zone (in a tie with Finland). Although CPI inflation in Ireland has converged downward toward the EU average through mid-2004, annual inflation since the late 1990s has consistently exceeded the EU average. During the same span, wage increases have been two to three times the EU

average.

B) Poor indigenous performance: Except for a few high-performing firms, real growth in the sales and exports of indigenous Irish enterprises was negligible between 1990 and 2002. The ESG report noted that a relatively small number of foreign-owned firms that chose Ireland as their base for serving European markets drove Ireland's strong economic performance in that span. Foreign-owned firms still account for over 85 percent of Ireland's exports by value.

C) Changes in EU policies: Grant aid limits for the EU-15 states will tighten after 2006, while those for the newer member states will be relatively high. Ireland's ability to provide grant assistance to attract foreign investment, a key element of earlier enterprise strategy, could thus evaporate in much of the country.

D) Accelerating globalization: China, India, and the new EU Member States have emerged as attractive FDI destinations, as they offer low costs, an ample supply of skilled labor, comparably low corporate taxes, and access to new markets.

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The Solution: Sales/Marketing Expertise and Technology/R&D
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¶5. The ESG's strategy to shore up Ireland's competitiveness is to enable enterprises to succeed in internationally traded services and high-value manufacturing through government-promoted enhancements in marketing/sales expertise and technological/R&D capability. The strategy, in particular, targets indigenous small and medium-sized firms.

A) Sales and Marketing: Ireland-based enterprises do not have strong outreach to international consumers when compared with firms in other trading countries, argues the ESG. Negligible real growth during the 1990s in indigenous firms' exports, most of which went to the UK, would suggest weak international sales management. Foreign-owned firms in Ireland have focused primarily on production as a single step in their parent companies' supply chains, with few selling directly to customers. To help firms understand and provide what customers want, the ESG proposes a new government entity called "Export Ireland," which would focus on export market intelligence and sales promotional activities. The ESG also suggests a five-year plan to place, on a cost-sharing basis, 1,000 graduates and internationally experienced professionals in Ireland-based firms to augment the stock of sales and marketing talent. (In discussions with the Embassy, ESG Chairman O'Driscoll highlighted this plan, expressing hope that the personnel could be sourced largely from the United States.)

B) Technology and R&D: Enterprises should simultaneously upgrade their technological/R&D capability to develop innovative, higher-value products and services, urges the ESG. The ESG report acknowledges Ireland's status as a world R&D leader in the IT and pharmaceuticals sectors. The report points out, however, that Ireland's total business expenditure on R&D is 0.88 percent of GDP, only 73 percent of the EU average and 57 percent of the OECD average. To encourage more R&D investment, the ESG proposes increased tax incentives and the establishment of "Technology Ireland," a government office that would coordinate R&D strategy among business-promotion agencies, in consultation with business networks. The ESG also recommends stronger collaboration between enterprises and academia, so that the latter "might generate the intellectual capital required to fuel an innovation-driven economy."

Ireland: The European Singapore

¶6. The drive to improve competitiveness reflects Ireland's natural anxieties as a small, open economy, econoff was told by Andrew McDowell, Forfas Department Manager for Trade and Innovation and a principal contributor to the ESG report. McDowell compared Ireland to Singapore, as both were newly prosperous countries of comparable population size aiming to succeed in competitive markets against larger neighbors and aggressive new entrants. As a euro-zone country, furthermore, Ireland could not rely on monetary policy tools, such as exchange rate adjustments, to enhance its competitiveness. Echoing the ESG report, McDowell said that Ireland's best bet was to move up the value chain to provide higher-end, innovative goods and services, ceding lower-end manufacturing to the new EU member states and Asia. He explained that higher relative costs in Ireland did not mean that enterprises could not achieve efficiencies to provide higher-value products. He cited Hewlett-Packard as an example of a foreign-owned enterprise in Ireland that had moved out of assembly operations, introduced novel R&D programs, developed new product lines, and expanded its work force despite rises in domestic cost/wage levels.

A Contrary View

¶7. Although competitiveness is a vulnerability in the Irish economy, the ESG's call to strengthen technological R&D and sales and marketing expertise in indigenous firms is overly ambitious," Irish Central Bank Assistant Director General Michael Casey told econoff. He argued that Irish firms, lacking economies of scale and a deep pool of highly educated labor, should simply copy (though not pirate) from foreign-owned enterprises, rather than invest heavily in R&D to pursue innovations of their own. Casey noted that Japan had used this strategy successfully in the formative years of its auto industry, with Japanese companies simply copying American car models before eventually developing their own distinctive styles. He noted that the dissemination of technology from foreign-owned to indigenous firms was already underway and that Irish firms intent on R&D investment would do better to focus on niche areas. Casey expressed confidence that foreign firms with substantial investments in Ireland would remain in country; his concern was that they would use their preponderant position in the economy to influence government policies on taxation and grant aid. Overall, he saw no downside to continued reliance on foreign-owned firms to sustain Ireland's economic success, quipping that "we've been getting away with that for 30 years."

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Comment: Steady as She Goes with U.S. Investment
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¶8. Despite Ireland's concerns on competitiveness, it would seem that U.S. firms continue to view the country as an attractive investment locale and export platform. In 2003, U.S. investment in Ireland was USD 4.7 billion, tripling the previous year's total and raising the total stock of U.S. investment (on a historical cost-basis) to USD 46.7 billion. This past year has seen the high-profile opening of Intel's new "Fab 24" wafer production facility, signaling the company's confidence in Ireland as a base to develop the next generation of micro-chip technology. U.S. subsidiaries in Ireland, in fact, see the competitiveness issue more in terms of the challenge to out-perform sister subsidiaries in other countries. The ESG's recommendations to help enterprises move further into high-value goods and services should thus be welcome news to U.S.-owned firms. As the ESG report notes, firms that can succeed in such transitions will hold greater strategic importance to their parent companies and, in turn, become more embedded in the Irish economy.
KENNY